

MASSACHUSETTS CASE STUDY AND OTHER LAWS

BY

CHRISTOPHER M. JEDREY, ESQ.

CHOATE, HALL & STEWART

Table of Contents

- A. Massachusetts Case Study: Attorney General Review of a Public Charity's Sale of Assets to a For-Profit Company, Christopher M. Jedrey.
- B. Medicare Recapture of Depreciation, Jeffrey L. Heidt and Christine G. Solt.
- C. Repayment of Obligations Under Hill-Burton Act, Jeffrey L. Heidt and Christine G. Solt.
- D. Licensure of Health Care Facilities and "Conversions" of Non-Profit Facilities to For-Profit Status, Christopher M. Jedrey and Christine G. Solt.
- E. Certificate of Need and "Conversions" of Non-Profit Facilities to For-Profit Status, Christopher M. Jedrey and Christine G. Solt.
- F. Public Information Requests and "Conversions" of Non-Profit Facilities to For-Profit Status, Christopher M. Jedrey and Christine G. Solt.
- G. Fundamentals of Mergers and Acquisitions, Robert M. Buchanan, Jr.



Christopher M. Jedrey, Esq.

CHOATE, HALL & STEWART
53 State Street
Boston, MA 02109
(617) 248-5049

MASSACHUSETTS CASE STUDY: ATTORNEY GENERAL
REVIEW OF A PUBLIC CHARITY'S SALE
OF ASSETS TO A FOR-PROFIT COMPANY

I. Notice to Attorney General

If an M.G.L. c. 180 corporation constituting a public charity intends to dispose (by sale, lease, exchange or other disposition, not including a mortgage, pledge or grant of a security interest) of all or substantially all of its assets, and if such disposition will result in a material change in its activities, the corporation must give written notice of such disposition to the Attorney General at least 30 days prior to the effective date of such sale. M.G.L. c. 180, § 8A(b) and (c). **For purposes of this outline, I will assume hereafter that the proposed disposition is a sale.** The Attorney General may give a written waiver of such notice before or after such sale. Any purchaser, lessee, transferee or other person may rely conclusively for purposes of determining compliance with M.G.L. c. 180, § 8A(c) on a certificate signed by an officer of the corporation stating that notice was not required, notice was given, or notice was waived by the Attorney General. Notwithstanding these statutory requirements, it is best

practice to consult with the Division of Public Charities (the "Division") in the Office of the Attorney General before a public charity sells any substantial asset other than in the ordinary course of its business. This consultation should take place prior to any public announcement of the proposed sale. See R. Allen [Director, Division of Public Charities], "Regulation of Public Charities and Fundraising," pp. 9-18 to 9-23 and 9-99 to 9-103 in Massachusetts Non-Profit Organizations, Vol. I, ed. F. Marx (MCLE: Boston, 1992) (hereinafter, "Allen Chapter").

II. Vote of Members

If the proposed sale of all or substantially all of an M.G.L. c. 180 public charity's assets will result in a material change in its activities, the public charity must secure the approval of the proposed sale by at least two-thirds of its members (or holders of its capital stock) entitled to vote. M.G.L. c. 180, § 8A(a). Prior notice of the meeting must be given to all members (or holders of capital stock) entitled to vote on any corporate action, whether or not they are entitled to vote on the proposed sale. M.G.L. c. 180, § 6B. The notice must be in a manner reasonably likely to make such members (or stockholders) aware of the proposed action, although a defect in the giving of such notice will not

invalidate or otherwise affect such action. Allen Chapter, p. 9-19.

III. Review by the Division of Public Charities

A. Public Charities

M.G.L. c. 180, § 2(f) defines a public charity as a corporation holding funds subject to the Attorney General's authority to oversee the "due application" of charitable funds and to prevent "breaches of trust in the administration thereof." M.G.L. c. 12, § 8. The Division takes the position that public charities include but are not limited to organizations exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code (e.g., most schools, colleges, museums, hospitals, etc.). Allen Chapter, pp. 9-2 to 9-6. In addition, the Division takes the position that health maintenance organizations exempt under Section 501(c)(4) of the Internal Revenue Code constitute public charities. The Attorney General has published community benefit guidelines for non-profit acute care hospitals (see Tab 1), and health maintenance organizations (see Tab 2), as well as a guide for board members of charitable organizations (see Tab 3). These guidelines and guide provide information about the Attorney

General's view of the duties of such organizations and their boards. See also documents from the recent Central Massachusetts Health Care/Healthsource and Metrowest Medical Center/Columbia/HCA transactions attached at Tabs 4, 5, 6 and 7.

B. Scope of Review¹

The scope and intensity of the Division's review of a proposed sale of charitable assets depends upon the facts and circumstances. In general, the sale of assets by a public charity to a for-profit entity will draw the closest and most comprehensive scrutiny. Allen Chapter, pp. 9-18 to 9-23.

C. Criteria²

The criteria used by the Division in reviewing the sale of a public charity's assets to a for-profit entity are as follows:

1. Rationale for Sale

If the proposed sale will materially change the

¹House Bill 5908, if enacted, would provide statutory authorization for the process followed by a Massachusetts subsidiary of Healthsource and the sale of MetroWest Medical Center to a joint venture controlled by an affiliate of Columbia/HCA Healthcare Corporation. See Tab 8. House Bill 5910, if enacted, would not allow the Department of Public Health to issue a hospital license to a for-profit company. See Tab 9.

²The Volunteer Trustees Foundation for Research and Education, a Washington, D.C. - based organization representing non-profit hospital boards, has recommended to the National Association of Attorneys General and the National Association of State Charity Officers that each state adopt rigorous criteria for reviewing proposed sales of non-profit hospitals to for-profit companies. BNA's Health Law Reporter, Vol. 4, pp. 1472-3 (Sept. 28, 1995). The criteria used by the Division in

activities of the public charity, the Division will examine very carefully the rationale for the sale. The public charity will be required to justify the sale generally in accordance with the standards applicable to cy pres or deviation proceedings, i.e., demonstrate that it is impracticable or impossible for the charity to continue without the sale. Scott on Trusts, 4th ed. (ed. W. Fratcher), §§ 381, 399. The Division will ask whether the charity has carefully considered alternatives to the proposed sale, especially a merger with or sale to another non-profit organization.

2. Duty of Care

The trustees, officers and senior managers of the public charity will be required to demonstrate that they have met their duty of care with respect to the proposed sale. M.G.L. c. 180, § 6C. This usually involves obtaining an independent appraisal by a qualified appraiser of the assets to be sold and negotiating a purchase price consistent with such appraisal. The trustees, officers and senior managers must be able to fully document their careful and

diligent consideration of the proposed sale, including but not limited to information concerning alternatives to the proposed sale and the financial and other terms of the proposed sale. The trustees, officers and senior managers should have competent legal and accounting advice with respect to the proposed sale. See the sample interrogatory at Tab 7.

3. Duty of Loyalty

The trustees, officers and senior managers of the public charity will be required to demonstrate that they have met their duty of loyalty with respect to the proposed sale. M.G.L. c. 180, § 6C. This usually involves demonstrating that no trustee, officer or senior manager (including, for this purpose, immediate family members of, and entities controlled by, such persons) stands to benefit from the proposed sale or, if one or more does, that such person's interest has been fully disclosed to the public charity's governing body and members (or holders of its capital stock). Such benefits might derive from ownership of stock in, or other significant business relationships with, the buyer

(including, for this purpose, entities or persons associated with the buyer), or a promise of a board position or employment with the buyer. Trustees and officers of the seller who stand to benefit from the proposed sale should not participate in negotiations with the buyer or the governing body's deliberations with respect to the proposed sale. If the buyer proposes to hire one or more of the seller's senior managers and the manager possesses knowledge or expertise useful to the board in its negotiations with the buyer, the trustees should make use of the manager's knowledge or expertise while carefully monitoring the manager's dealings with the buyer. See the sample interrogatory at Tab 7.

4. Use of Sale Proceeds

The public charity must present to the Division a plan for the use of proceeds of the sale generally consistent with cy pres or deviation standards, i.e., a use as near as possible to the original use. Scott on Trusts, 4th ed. (ed. W. Fratcher), §§ 381, 399. This criteria is hardest to meet when the public charity is

selling all of its assets, and thereafter lacks the capacity to carry out its original purposes. See Attorney General v. Hahnemann Hospital, 397 Mass. 820, 833 (1986) (sale of freestanding non-profit hospital to a for-profit entity is permissible, but charity does not have complete freedom to alter the purposes for which the charitable assets may be expended); Allen Chapter, pp. 9-21 to 9-23. In addition, the Division will require that the recipient of sale proceeds (e.g., the seller or another public charity) have a board of trustees and management that does not overlap at all with the buyer's board and management, and not be otherwise subject to the control or influence of the buyer. The Division also will ask whether the seller itself should use the sale proceeds for the approved charitable purpose, or, in the interests of reducing administrative costs, pay over the proceeds to an existing charity with similar purposes.

D. Process

1. Required Submissions

Depending upon whether for-profit entities are involved, the percentage of the public charity's assets

being disposed of, and the significance of the change in the public charity's activities caused by the sale, the review process can range from informal telephone discussions with follow-up correspondence to confirm certain details of the proposed sale to the filing of a complaint by the public charity in a court of competent jurisdiction seeking the court's approval of the proposed sale (see Tabs 6 and 7). Boston Bar Association, Bringing Equity Actions in the Probate Courts - A Practical Guide (Boston, 1996), Chapter V. In situations deemed by the Attorney General to require the closest scrutiny, the Division may hold a hearing or publish a notice seeking public comment on the proposed sale, secure sworn statements from the trustees, officers and senior managers with respect to their compliance with their duty of loyalty and duty of care (see Tab 3), and/or ask the parties to pay for an independent review of the financial terms of the proposed sale. The Attorney General also may ask for an "anti-flip" provision, i.e., an agreement by the buyer that if it resells the charitable assets within a specified period for a price higher than the purchase price, it will

pay a portion of the difference to the seller public charity.

2. Exclusive Jurisdiction

The Attorney General is the exclusive representative of the public interest in proceedings relating to public charities, and is a necessary party to such proceedings. M.G.L. c. 12, § 8G; Lopez v. Medford Community Ctr., Inc., 384 Mass. 163, 167 (1981); Ames v. Attorney General, 332 Mass. 246, 250-51 (1955). No party other than the public charity and the Attorney General has standing in such a proceeding, unless the party can show an interest in the matter distinct from that of the general public (e.g., a holder of a reversionary interest in the assets being disposed of). Lopez, at 167-170.

3. Court Review

In most cases, the complaint (if one is required) is filed with the court after careful review by the Division, which may involve negotiation between the public charity and the Attorney General with respect to the asset purchase agreement or other aspects of the

transaction. If the Attorney General is satisfied that the proposed sale is consistent with the public interest, he will consent to the relief sought by the public charity. If the Attorney General's consent is obtained, the court can, but usually does not, require the issues in the complaint to be briefed or testimony to be given prior to approving or disapproving proposed sale. In most cases, the court will grant the relief sought in a complaint which has been consented to by the Attorney General, although it is not obligated to do so.

Town of Brookline v. Barnes, 327 Mass. 210 (1951).

IV. Tax and Other Regulatory Considerations³

A. State Corporate Excise Tax

The corporate excise tax does not include a tax on the unrelated business income of a tax exempt corporation. Therefore, all income, including sale proceeds, received by an exempt organization is exempt from the corporate excise tax. M.G.L. c. 63, § 30.

B. State Sales Tax

Casual and isolated sales by a vendor who is not

³This Section does not include any discussion of federal tax issues.

regularly engaged in retail sales are exempt from the sales tax, except for sales of motor vehicles, trailer boats or airplanes.

M.G.L. c. 64H, § 6(c).

C. Disclosure to Division

If the buyer is a "related party," the transaction must be reported on the seller's next Form PC filed with the Division. The Division defines a "related party" as a trustee, officer or management employee of the public charity, an immediate family member of any of the preceding, or a corporation, trust, estate or partnership, more than 35% of which is owned or held by any of the preceding. This disclosure requirement must be complied with even if the notice requirement described in Section I above does not apply.

D. Licensing Agencies and Accrediting Bodies

If the seller is authorized by a government agency or accrediting body to provide certain services (e.g., health care, education), the buyer must seek the transfer or new issuance of such licenses or accreditations to it.

E. Other Issues

The sale of charitable assets may affect some or all of the following:

1. Religious or donor-imposed restrictions on the use of funds or other assets (e.g., land, buildings, etc.).
2. The rights of the public charity's employees (e.g., collective bargaining agreements, pension plans, etc.).
3. Covenants under mortgages, bond indentures or other debt instruments to which the public charity is subject.
4. Contracts between the public charity and third parties which are important to the continuation of the public charity's business, which is being sold (e.g., for hospitals, contracts with payors; for HMOs, contracts with employers).

F. Post-Closing Issues

If the purchase price or sale proceeds could be reduced by post-closing events (e.g., retained liabilities, indemnifications, etc.), these contingencies must be fully disclosed to the Attorney General.

Jeffrey L. Heidt, Esq.

Christine G. Solt, Esq.

CHOATE, HALL & STEWART
53 STATE STREET
BOSTON, MA 02109
(617) 248-5000

Medicare Recapture of Depreciation

In some cases, the "conversion" of a non-profit health care organization will require the non-profit provider to sell certain assets to a third party. If these assets are depreciable and the cost of depreciation has been claimed as an allowed cost, the Medicare program will share a portion of the gain or loss resulting from the sale of those assets. As a result, facilities want to minimize the amount of depreciation recaptured by the Medicare program and minimize the amount of any loss recovered from the Medicare program. In the case of an inpatient acute care hospital, the amount of loss included in allowable cost is limited to the undepreciated basis of the asset prorated in accordance with the proportion of the asset's useful life for which the hospital participated in the Medicare program; allocated to all reporting periods under the Medicare program; multiplied by the ratio of Medicare reimbursable cost to total allowable cost for each reporting period; and then the results for each year are added with the exception that losses attributable to inpatient services for any year for which the hospital was paid under the "fully prospective" or "hold harmless" payment methodologies are excluded. 42 C.F.R. § 413.134(f)(2).

- I. Strategies to Minimize Recapture of Depreciation if Assets are Sold at a Gain.
 - A. Delay sale of the asset for one year after the provider exits the Medicare program. Under the regulations governing recapture, if the facility has not been a Medicare provider for the twelve months preceding the sale, no gain will be recognized. 42 C.F.R. § 413.134 (f)(3).
 - B. Allocate the maximum possible amount of the purchase price away from highly depreciated assets.
 - C. Acquire assets through stock transactions rather than asset purchases.
 - D. Accept a lower purchase price in exchange for non-cash consideration. See Jeffrey L. Heidt, Sale of a Non-Profit Entity of a Substantial Asset to a For-Profit Company, Health Care Corporate Law: Facilities and Transactions (1996).

- II. Considerations in Shaping Transaction
 - A. business plans must incorporate anticipated gains or losses
 - B. purchase and sale agreement should anticipate possible losses or gains recognized by Medicare or other third parties.

Below are a few examples of certificate of need programs:

I. Massachusetts

A. Massachusetts defines "health care facility" as:

a hospital, an institution for unwed mothers or a clinic, including an out-of-hospital dialysis unit, as defined under M.G.L. c. 111, § 52 (1996); or a long-term care facility, including an infirmary maintained in a town, a convalescent or nursing home, a rest home, a charitable home for the aged, or an intermediate care facility for the mentally retarded, as defined under M.G.L. c. 111, § 71 (1996); a clinical laboratory subject to licensing under M.G.L. c. 111D (1996); or a public medical institution. 105 CMR 100.020.

B. A DoN application for a change in ownership is considered a "unique" application and may be filed with the Department of Public Health on any day. The applicant shall be the entity that will be issued an original license following the transfer of ownership. 105 C.M.R. 100.600.

C. Full DoN review of a change in ownership is not always necessary. If the facility can meet certain standards, including assurances of local control (majority of board consists of local residents), compliance with

Medicare dumping provisions and Medicaid access provisions, affiliation with an existing licensed hospital, and provision of a specific level of bad debt or free care for at least 24 months after the transaction, only a simple application and approval by the Commissioner of Public Health under a delegated review process will be required. If the application has been on file for twenty (20) days and no action has been taken, the conversion is deemed to be authorized by the Department of Public Health. 105 C.M.R. 100.602

- D. Other conditions may be imposed on proposed transferees. For example, in some cases, interpreter services must be provided before DoN approval will be granted. See David Harlow, Hospital Mergers, Acquisitions and other Evolutions - The Department of Public Health Perspective, (MCLE-Boston, 1994) at Appendix 3 (letter from Commissioner of Public Health dated March 16, 1993 approving transfer of ownership of Burbank and Leominster Hospitals).

II. Connecticut

- A. The Office of Health Care Access must approve any transaction where the parties intend to transfer part or all of the ownership interest of a health care facility before it is initially licensed. Conn. Gen. Stat. Ann. § 19a-154 (excluding home health agencies, nursing homes, homes for the aged and certain homes for the mentally retarded). As in Massachusetts, facility licenses in Connecticut are

particular to the owner and location so that any acquisition will require CoN review. Conn. Gen. Stat. Ann. § 19a-493 (West 1996).

- B. A CoN is required for a range of other activities undertaken by or on behalf of a health care facility or institution, including (1) the introduction of new services, (2) the termination of health services, (3) a reduction in total bed capacity, (4) a capital expenditure exceeding \$1 million, or (5) the acquisition of major medical equipment requiring a capital expenditure of over \$400,000. Conn. Gen. Stat. Ann. § 19a-145 et seq. (West 1996).

III. Maine

- A. Following amendments to the state's CoN provisions in 1989, Maine has made transfers of hospital ownership reviewable, but will not require review in all instances. Me. Rev. Stat. Ann. tit. 22 § 304-A (3A) (B) (West 1995). Transfers of ownership of an existing home health care provider are always reviewed. Me. Rev. Stat. Ann. tit. 22 § 304-A (8) (B) (2) (West 1995).

- B. A CoN will also be required for other activities undertaken by or on behalf of a variety of health care facilities, including acquisitions of major medical equipment. Me. Rev. Stat. Ann. tit. 22 § 304-A (West 1995).

IV. New Hampshire

- A. A CoN is required for the transfer of ownership of an existing facility

or the acquisition of all, or substantially all, of its assets or stock. Capital expenditures in excess of \$400,000 involving diagnostic or therapeutic equipment are also subject to review. N.H. Rev. Stat. Ann. § 151-C:5 (II) (b), (d) (1995). For CoN purposes, a health care facility is defined to include:

hospitals, ambulatory surgical facilities, specialty hospitals and licensed nursing homes including all services and property owned by such. Health care facilities shall include facilities which are publicly or privately owned or for-profit or not-for-profit, and which are licensed or required to be licensed in whole or in part by the state.

N.H. Rev. Stat. Ann. § 151-C:2 (1995).

V. Rhode Island

A. Rhode Island does not require determination of need review for transfers of ownership. DoN approval is required, however, for major capital expenditures, new institutional health services, and new health care equipment. R.I. Gen. Laws § 23-15-4 (Michie 1995).

VI. Vermont

A. Vermont explicitly exempts the purchase or lease of an existing health care facility or HMO from CoN review. Vt. Stat. Ann. tit. 18 § 9434

(1996). A CoN is necessary, however, for (1) construction, development, or other establishment of a new health care facility or HMO, (2) capital expenditures in excess of \$300,000, and (3) acquisitions of equipment totaling in excess of \$250,000. Health care facilities include: all facilities and institutions, whether public or private, proprietary or not-for-profit, which offer diagnosis, treatment, inpatient or ambulatory care to two or more unrelated persons. Vt. Stat. Ann. tit. 18 § 9432 (10) (1996).

Jeffrey L. Heidt, Esq.

Christine G. Solt, Esq.

CHOATE, HALL & STEWART
53 STATE STREET
BOSTON, MA 02109
(617) 248-5000

Repayment of Obligations Under Hill-Burton Act

Health care facilities need to examine whether their obligations under the Hill-Burton Act have been met before moving forward with a conversion. The Hill-Burton Act, codified at 42 U.S.C. § 291 and enacted in 1946, provided funds for states to assist in the construction and expansion of public and non-profit hospitals among other facilities. In exchange, states were required to pass licensure statutes governing hospitals, and Hill-Burton recipients were required to provide care to indigents and remain as a public or non-profit facilities for at least twenty years. The program was replaced in 1975 and most facilities met their initial service obligations years ago.

If, however, a facility has not met its Hill-Burton obligations, the government is entitled to receive a portion of the funds originally granted. This means that in a sale or joint venture transaction, both parties will become jointly and severally liable for the amount owed. Furthermore, failure to eliminate liability under the Act may delay a settlement of the closing facility's accounts. See e.g. United States v. St. James Parish, 792 F.Supp. 1410 (E.D. La. 1992); United States v. St. John's Gen. Hosp., 875 F.2d 1064 (3d Cir. 1989). The government's right to recover funds does not constitute a lien on the facility.

Christopher M. Jedrey, Esq.

Christine G. Solt, Esq.

CHOATE, HALL & STEWART
53 STATE STREET
BOSTON, MA 02109
(617) 248-5000

Licensure of Health Care Facilities

When ownership of a hospital or other health care facility is transferred, the resulting entity will need to either secure a transfer of the original facility's license or apply for an new or "original" license. See MacDonald, Treatise on Health Law, § 4.03[4][d] (1996). See e.g. Cal. Health & Safety Code § 1267.5 (West 1990); Long Island Home, Ltd. v. Whalen, 62 A.D.2d 23, 404 N.Y.S. 53 (3d Dept. 1978).

Some jurisdictions model their licensure requirements on Joint Commission on Accreditation of Healthcare Organizations (JCAHO) standards. Most jurisdictions require prospective licensees to demonstrate financial solvency, a history of successful operations in the state or other states, a commitment to providing some free or subsidized care, and a history of compliance with federal and state regulations.

I. Massachusetts

A. Both hospitals and clinics must be licensed pursuant to Mass. Gen. L. ch. 111 § 51 (1996). Clinics are defined to include all for-profit and non-profit organizations advertised, announced, established or maintained for the purpose of "providing ambulatory medical, surgical, dental, physical rehabilitation or mental health services." Mass. Gen. L. ch. 111 § 52 (1996).

B. When ownership of a licensed facility is transferred, the resulting

institution must acquire an "original" license from the Department of Health's Division of Health Care Quality. An "original" license is defined as the first license issued to an owner of a facility to operate at a particular location. Mass. Gen. L. ch. 111, § 52 (1996).

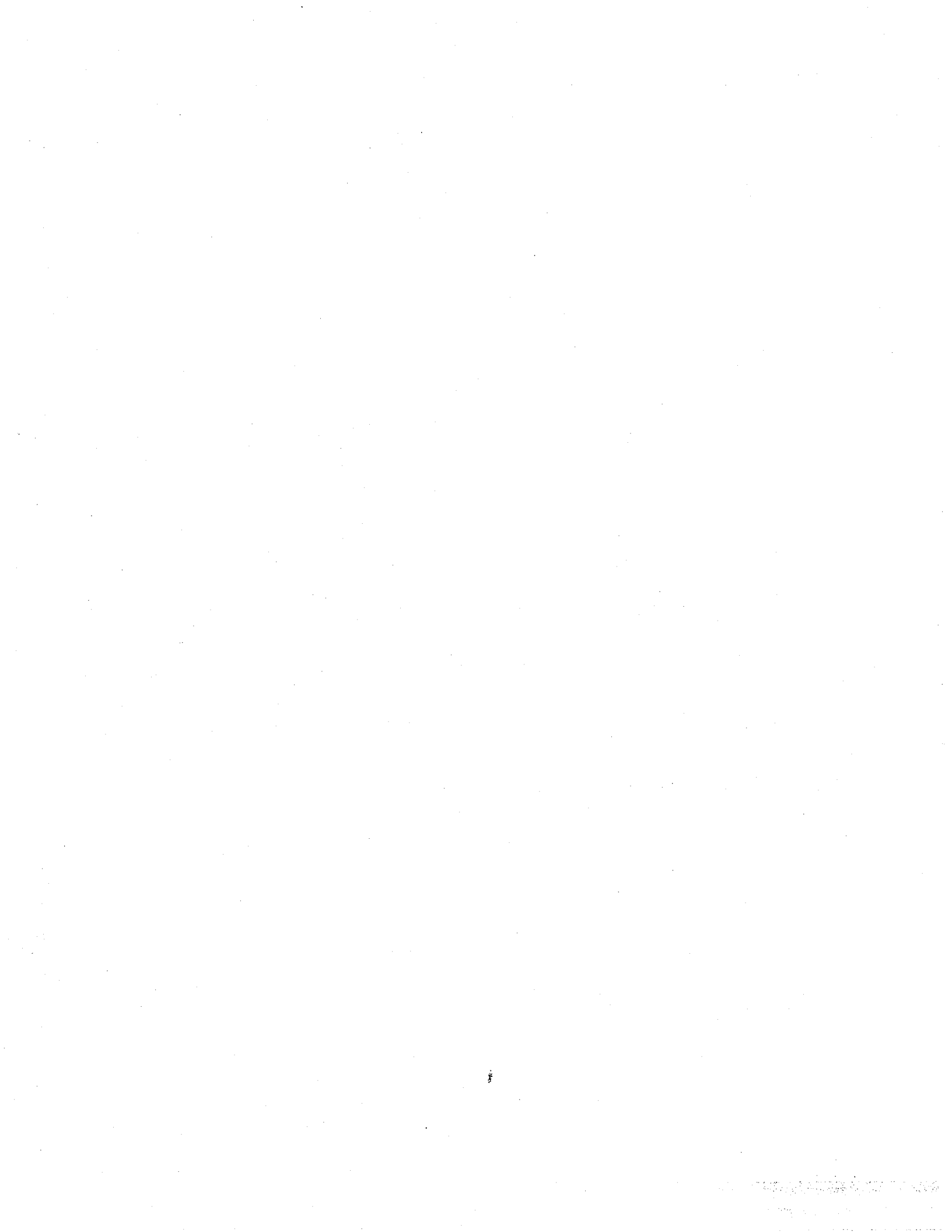
- C. Before obtaining a license, a prospective licensee must be deemed suitable and responsible to operate the facility by the Division of Health Care Quality. Suitability may be evidenced by the following:
1. financial capacity to operate the facility in accordance with state and federal law
 2. a history of providing acute care in compliance with the laws of those states in which it has operated
 3. participation by local members of the community in the facility's governance
 4. the absence of a significant impact on the availability or accessibility of health care services in the affected area as a result of the transaction 1995 H. B. 5908 (proposed M.G.L. ch. 111 § 51G (1996)) (See Tab 8). Current suitability requirements may be found at 105 C.M.R. 130.104 (hospitals), 105 C.M.R. §§ 140.104, 140.109 (clinics), and 105 C.M.R. 153.009, 153.012 (long-term care facilities).

II. New Hampshire

- A. In New Hampshire, a license is required for the operation of hospitals,

V. Connecticut

- A. Licensure is required for all health care facilities in Connecticut. Conn. Gen. Stat. Ann. § 19a-154 (West 1996). Once obtained, a license is specific both to the owner and location of the facility, and thus is non-transferable and non-assignable. Conn. Gen. Stat. Ann. § 19a-493 (West 1996). Purchase of a health care facility will therefore require the purchaser to obtain an original or "initial" license before the transfer may take place. In addition, transfers of part or all of one's ownership in a health care facility, with the exception of home health agencies, nursing homes, homes for the aged and certain homes for the mentally retarded, require certificate of need approval. Conn. Gen. Stat. Ann. § 19a-154 (West 1996).



Christopher M. Jedrey, Esq.

Christine G. Solt, Esq.

**CHOATE, HALL & STEWART
53 STATE STREET
BOSTON, MA 02109
(617) 248-5000**

Certificate of Need

In 1974, the National Health Planning and Resources Development Act required states to implement a certificate of need ("CoN") program to limit the number and expansion of health care facilities within their borders. Despite the Act's repeal in 1986, thirty-eight states still utilize some fashion of certificate of need program to require various health care facilities to obtain prior approval for significant corporate transactions. See MacDonald, Treatise on Health Care Law, § 4.06[5] (1996) (detailing the current status of each state's CoN provisions).

Transactions typically governed by certificate of need laws include, but are not limited to, the construction of new facilities, the transfer of beds from one facility to another, the acquisition or disposition of expensive medical equipment, large capital expenditures, and, in some cases, dissolutions. Recognizing in the late 1980s that mergers and acquisitions were becoming an easy means of avoiding CoN requirements, many states added provisions to prevent transfers of ownership without CoN approval.

In Massachusetts, before a person may acquire an existing health care facility, a notice of interest must be filed with the Department of Public Health and the

acquisition may be subject to DoN (determination of need) review if it fails to meet certain criteria. Other states requiring approval before a change in ownership may occur include New Hampshire, North Carolina, Ohio, and Washington. See Wash. Rev. Code Ann. §§ 70.38.015-38.920 (1975 and Supp. 1991); Appeal of Nashua Brookside Hosp., 636 A.2d 57 (N.H. 1993); In re Mercy Hosp. v. Department of Health, No. 92AP-1630, slip op. 1993 WL 104887 (Ohio Ct. App. 1993); Lenoir Mem. Hosp. v. Dept. of Human Resources, 98 N.C. App. 178, 390 S.E.2d 448 (N.C. Ct. App. 1990).

If your state has a certificate of need program governing transfers, a notice of interest should be filed with the appropriate agencies, and the facilities involved should be prepared for further review by the state's department of health or an analogous body. In some jurisdictions, final approval of the transaction may also require legislative or judicial review or favorable public hearings. See e.g. Tex. Health & Safety Code § 61.063 (requiring public hearings).

home health care providers, laboratories, facilities or portions of a facility operating as an outpatient rehabilitation clinic, ambulatory surgical centers, community health clinics, hospices, emergency medical care centers, drop-in or walk-in care centers, dialysis centers, birthing centers, residential care facilities, adult day care facilities, and other entities where health care associated with illness, injury, deformity, infirmity or other physical disability is provided. N.H. Rev. Stat. Ann. § 151:2 (West 1996).

- B. Licenses are issued to a particular organization to provide services on specific premises and are not transferable or assignable. N.H. Rev. Stat. Ann. § 151:5 (West 1996). This will require prospective purchasers to obtain a new license and receive certificate of need approval. 1 N.H. Op. A.G. 53; N.H. Rev. Stat. Ann. § 151:5 (II) (b) (West 1996).

III. Rhode Island

- A. Health care facilities must be licensed in Rhode Island. R.I. Gen. Laws § 23-17-4 (Michie 1995). Health care facilities include "any institutional health service provider, facility or institution, place, building, agency, or portion thereof, whether a partnership or corporation, whether public or private, whether organized for-profit or not, used, operated, or engaged in providing health care services" R.I. Gen. Laws § 23-17-2 (Michie 1995).
- B. Licenses are granted to specific persons and locations and are not

transferable or assignable, except with the written approval of the licensing agency. R.I. Gen. Laws § 23-17-6 (Michie 1995).

C. When a change in ownership is proposed, the Health Services Council shall review the licensure application of the purchaser and shall specifically consider the following:

1. the character, competence and standing in the community of the proposed owners, operators or directors,
2. the extent to which the facility will continue without material effect to provide safe and adequate treatment to its patients, and
3. the continued access to services which will be afforded to traditionally underserved populations.

R.I. Gen. Laws § 23-17-14.3 (Michie 1995).

IV. Vermont

A. Licensure is limited to hospitals and nursing homes. Vt. Stat. Ann. tit. 18, § 1903; Vt. Stat. Ann. tit. 33, §§ 7101-7118 (1996). Licenses are neither transferable nor assignable and are issued to a specific owner for operation at a particular location. As a result, purchasers will have to demonstrate their ability to meet minimum operating standards set forth in the licensure statute, including specific financial solvency and indigent care requirements. Vt. Stat. Ann. tit. 18, § 1905 (1996).

Christopher M. Jedrey, Esq.

Christine G. Solt, Esq.

CHOATE, HALL & STEWART
53 STATE STREET
BOSTON, MA 02109
(617) 248-5000

Public Information Requests

It is often the case that citizens' groups, journalists, or competitors will seek the release of conversion-related documents submitted by an organization to the state Attorney General, Department of Public Health, or other relevant agency. Requests for this information may come during or even after the transaction. Most likely, these groups will rely upon federal and state public records laws to obtain previously submitted information. As a result, attorneys for the parties should be familiar with the relevant state public records laws and, more particularly, the exceptions to those laws.

I. Public Records Laws in General

- A. Most states define public records broadly to include any "papers, . . . , financial statement, statistical tabulation or other documentary materials or data, regardless of physical form or characteristics, made or received by any officer or employee of any agency, executive office, department, board, commission, bureau, division or authority of the commonwealth. . . or of any authority established by the general court to serve a public purpose." M.G.L. c. 7, § 4 (1996).

- B. Exceptions to public records laws are usually strictly construed and the custodian of the records must prove that the requested documents are not within the purview of public records. See e.g. Hull v. Municipal Lighting Plant v. Massachusetts Mun. Wholesale Elec. Co., 414 Mass. 609 (1993). Furthermore, the custodian of the documents must prove "with specificity" which exemption applies. Wolfe v. Massachusetts Port Auth., 366 Mass. 417, 421 n.3, 319 N.E.2d 423, 426 (1974); Bougas v. Chief of Police of Lexington, 371 Mass. 59, 61 (1976).
- C. In many states, there is no requirement that a document be required by law to be received in order to qualify as a public record, such that the gratuitous making or receiving of a record not required to be made or received by law will qualify the record as public. 39 Mass. Prac., Cella § 1162, n.2.
- D. When protection from disclosure is sought, the following policy issues will usually be considered: whether the legislature intended the document to be available to the public, whether it would be fair to permit it to be available, or whether permitting its dissemination would discourage complete disclosure of information in the future. Gerry v. Worcester Consolidated St. Ry. Co., 248 Mass. 559, 566-568 (1924) (incident report made to the Industrial Accident Board was inadmissible in a wrongful death action as it was not a public record).

If no exemption applies, the records must be produced in accordance with the state's public records law.

II. Relevant Exemptions

A. Trade Secrets or Commercial Information

1. States

- a) One of the most significant public records exceptions protects the confidentiality of "trade secrets or commercial or financial information voluntarily provided to an agency for use in developing governmental policy and upon a promise of confidentiality." See M.G.L. c. 4, § 7 (26) (g) (1996).
- b) One must examine the authority under which the Attorney General's Office or other state agency requests information to determine whether the information must be turned over.
- c) In some states, this exemption only applies if commercial information was provided or demanded to develop governmental policy. This requirement may be met if the agency has acknowledged concerns about the acquisition of not-for-profit health care institutions by for-profit entities but does not yet have a clear position on the issue. At least one

Massachusetts case protected information under this exemption despite the absence of its use in government policy development. Healy v. Murphy, 357 Mass. 728 (1970)(*citing* Restatement of Torts §757).

- d) The commercial information exemption does not apply if material was produced without securing a promise of confidentiality. A cover letter to the agency requesting confidentiality should be sent in response to the first request for information. The parties should ask for the agency to confirm in writing its assent to this request.

2. Federal Freedom of Information Act - The federal corollary to a state's trade secret or commercial information exemption is found at 5 U.S.C.A. § 552 (b) (4). Its provisions are very broad.

- a) FOIA exempts from disclosure "trade secrets and commercial or financial information obtained from a person and privileged or confidential." The information need not have been provided voluntarily, nor is a promise of confidentiality required.
- b) A two-part test has been adopted by a majority of

federal circuits on the issue of confidential commercial information. The test was outlined in National Parks and Conservation Ass'n v. Morton, 498 F.2d 765, 770 (D.C.Cir. 1974) and states that commercial or financial information is confidential for purposes of Exemption 4 if disclosure of the information is likely" (1) to impair the Government's ability to obtain necessary information in the future, or (2) to cause substantial harm to the competitive position of the person from whom the information was obtained." See also Greenberg v. F.D.A., 803 F.2d 1213 (D.C. Cir. 1986); Public Citizen Health Research Group v. F.D.A., 704 F.2d 1280 (1983).

- c) Other factors to be considered, according to National Parks and Conservation Ass'n v. Kleppe, 547 F.2d 673, 679 (D.C. Cir. 1976), include the nature of the material sought and the competitive circumstances in which the defendants do business.

3. Benefits of Commercial Exemption

- a) The benefits of protecting commercial information include: encouraging the provision of information to the government (Soucie v. David, 448 F.2d 1067

(1971)), protecting the competitive position of citizens offering information to assist policy-makers (Bristol-Myers Co. v. F.T.C., 424 F.2d 935 (1970)), and protecting plans relating to "expansions, reductions, mergers," (Sears, Roebuck & Co. v. G.S.A., 384 F.Supp. 996, *aff'd* 509 F. 2d 527 (D.C.D.C. 1974)).

B. Investigatory Materials Exemption

1. The second public records exemption available is the investigatory materials exemption which protects those "materials necessarily compiled out of the public view by law enforcement or other investigatory officials, the disclosure of which materials would probably so prejudice the possibility of effective law enforcement that such disclosure would not be in the public interest." See e.g. M.G.L. c. 4, § 7 (26) (f) (1996); WBZ-TV4 v. District Atty. for the Suffolk Dist., 408 Mass. 595 (1990).
2. Once an investigation is complete, however, the investigatory materials exemption is no longer available.
3. There are additional circumstances under which the supervisor of public records will permit the disclosure of investigatory materials. In Massachusetts, for example, the exemption only applies to records compiled for the purpose

of civil or criminal law enforcement, and even then only where disclosure would sufficiently prejudice the possibility of effective law enforcement. See Supervisor of Public Records, No. 1032 (March 11, 1982) (DPH reports regarding an investigation of a hepatitis outbreak were not exempt from public disclosure); Bougas v. Chief of Police of Lexington, 371 Mass. 59, 62 (1976) (no blanket exemption exists for all documents contained in police files, especially if document is merely factual).

C. Executive Policy Making (Inter- or Intra-Agency Memoranda) Exemption

1. To the extent that information obtained by the Attorney General's Office was requested only to help establish executive policy, the arguments for protection from disclosure wane. See e.g. M.G.L. c. 4, § 7 (26)(h) (1996), 5 U.S.C.A. § 552 (b) (5).
2. While documents provided to government agencies are typically protected while the policy is still being formulated, even interagency memos relating to policy positions become generally available to the public once the deliberative process is complete. See Babets v. Secretary of Human Services, 403 Mass. 230 (1988).

D. Exemption From Disclosure By Specific Statute

1. If a separate and specific statute indicates that particular materials need not be disclosed to the public, that statute will usually supersede any general disclosure requirements under that state's public records law. See e.g. M.G.L. c. 4, § 7 (26) (a) (1996).

E. Attorney-Client Privilege

1. Finally, to the extent that the information provided to a state Attorney General contains legal implications or potentialities of particular incidents, parties can make the argument that the commercial and business information is privileged by virtue of the attorney-client privilege. See Miller, Anderson, Nash, Yerke & Wiener v. U.S. Dept. of Energy, 499 F.Supp. 767 (D.C. Or. 1980).

Robert M. Buchanan, Jr., Esq.

CHOATE, HALL & STEWART
Boston, MA 02109
(617) 248-5000

FUNDAMENTALS OF MERGERS AND ACQUISITIONS¹

This outline presents the fundamentals of antitrust analysis of mergers and acquisitions. Part I lists the applicable statutes. Part II sets forth the fundamental concepts which are employed in the case law and the enforcement statements. Part III reviews enforcement. Part IV illustrates these fundamentals by summarizing how they are being applied currently to hospital mergers and acquisitions.

I. STATUTES

- A. Section 7 of the Clayton Act, 15 U.S.C. § 18, prohibits a merger or acquisition, "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." Section 7 is intended to halt anti-competitive mergers before they occur and "to arrest incipient threats to competition." U.S. v. Penn-Olin Chemical Co., 378 U.S. 158, 170-71 (1964). Thus, the enforcement agency (or other party

¹I gratefully acknowledge the assistance of Christine G. Solt of Choate, Hall & Stewart.

challenging a merger) need not prove that the threat of the merger has already harmed competition; it need prove only that the merger "may" lessen competition. However, the proof must show that the merger may lessen competition "substantially" or "tend to create a monopoly." Ordinarily, the enforcement agency (or other party challenging the merger) must advance a cogent definition of the relevant market in which these effects will be felt. See United States v. E.I. du Pont de Nemours & Co., 353 U.S. 586, 593 (1957).

- B. Section 1 of the Sherman Act, 15 U.S.C. § 1, prohibits a "contract, combination, or conspiracy" in restraint of trade. It too, applies to mergers. Recent cases have held that the standard to be applied under Section 1 of the Sherman Act is the same as the standard to be applied under Section 7 of the Clayton Act, see, e.g., United States v. Rockford Memorial Corp., 898 F.2d 1278 (7th Cir. 1990), cert. denied, 498 U.S. 920 (1990), although this is not settled.
- C. Section 2 of the Sherman Act, 15 U.S.C. § 2, prohibits monopolization and attempts to monopolize. It may be applied to acquisitions by a firm which already dominates the relevant market.
- D. Section 5 of the Federal Trade Commission Act, 15 U.S.C. §

45, declares that "unfair methods of competition in or affecting commerce" are unlawful. It gives the FTC some additional authority beyond the letter of the other antitrust statutes.

- E. The Hart-Scott-Rodino Act, 15 U.S.C. § 18a, applies to most large mergers and acquisitions. It requires that both parties to such transactions give notice to the Antitrust Division of the Department of Justice ("DOJ") and to the Federal Trade Commission ("FTC") (jointly, the "federal Agencies"). See section III(D) below. It assures that the federal Agencies have an opportunity to review large mergers before they are consummated.
- F. State Statutes. Many states have statutes which permit a challenge to a merger or acquisition. A collection of state antitrust statutes and interpreting material may be found in ABA Antitrust Section, *State Antitrust Practice and Statutes* (1990). The federal statutes apply only where the merger or acquisition has some effect on interstate commerce. In practice, however, this test is easily met. See, e.g., Summit Health Ltd. v. Pinhas, 500 U.S. 322 (1991).
- G. Summary. Section 7 of the Clayton Act and the other statutes which apply to mergers and acquisitions are simple in

formula.² As is true elsewhere in antitrust law, however, they have given rise to a complex body of case law and enforcement history.

II. FUNDAMENTAL CONCEPTS

A. Market Definition.

Before the court can assess whether a proposed merger is likely to lessen competition substantially, "[d]etermination of a relevant market is a necessary predicate." U.S. v. E.I. du Pont de Nemours & Co., 353 U.S. 586, 593 (1957). The enforcement agency (or other party challenging the merger) must prove the definition of the relevant product market and must also prove the relevant geographic market. Brown Shoe Co. v. United States, 370 U.S. 294, 324-28 (1962).

1. Product Market.

Where consumers are willing to substitute one product for another, both products must be included in the definition of the relevant market. For example, cellophane and aluminum foil may or may not belong in the same

² The one exception is the Hart-Scott-Rodino Act, which is moderately complex and has given rise to a further complex set of regulations and interpretations.

product market, depending on whether consumers are willing to switch between them. If "a slight decrease in the price of cellophane causes a considerable number of customers of other flexible wrappings to switch to cellophane, it would be an indication that a high cross-elasticity of demands exists between them; that the products compete in the same market." du Pont, 351 U.S. 377, 400 (1956). The measurement of consumer willingness to substitute is known as the cross-elasticity of demand. Thus "[t]he outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it." Brown Shoe, 370 U.S. at 325.

The party opposing the merger will naturally seek to define the market as narrowly as possible, and the courts have had occasion to be alert for artificially narrow definitions. See, e.g., U.S. v. Grinnell Corp., 384 U.S. 563, 591 (1966) (Fortas, J., dissenting) (arguing against a "strange red-haired, bearded, one-eyed man-with-a-limp classification"). Some

examples of notable cases involving a disputed product market include the following: In re Coca-Cola, Co., FTC Final Order Dkt. No. 9207, 5 Trade Reg. Rep. (CCH) ¶ 23,625 (June 28, 1994), as modified, id. at ¶ 23,822 (May 25, 1995)(distinguishing brand name carbonated beverage concentrate from concentrate of generic or private label brands); Syufy Enterprises v. American Multicinema, Inc., 793 F.2d 990, cert. denied 479 U.S. 1031 (1987) (distinguishing "industry anticipated top-grossing films from other first run films"); Nifty Foods, Corp. v. Great Atlantic & Pacific Tea Co., 614 F.2d 832 (2d Cir. 1980)(placing brand-name frozen waffles and private label frozen waffles in the same market).

The DOJ and the FTC, in their Horizontal Merger Guidelines, have announced a test which asks the economic question directly. See section III(A) below. The FTC and the DOJ initially posit a market comprised of the merging firms and their closest competitors. If those firms were to raise price by a significant but non-transitory amount, they

ask, would the price increase be profitable -- or would consumers switch to other products?

The Supreme Court has not given sustained attention to defining the product market since its 1962 Brown Shoe decision. Brown Shoe listed several considerations which may help determine the product market in a given case:

- * separate economic entities;
- * peculiar characteristics & use of a product;
- * unique production facilities;
- * distinct customers;
- * distinct prices;
- * specialized vendors.

See Brown Shoe, 370 U.S. at 325. Recent decisions in the Courts of Appeals often ignore the Brown Shoe criteria. In Blue Cross & Blue Shield of Wisconsin, et al. v. Marshfield Clinic, et al., 65 F.3d 1406, 1410-11 (7th Cir. 1995; petition for cert. filed Jan. 11, 1996), for example, Judge Posner referred to "contemporary principles of antitrust analysis." (The case held that HMOs did not constitute a separate

market, apart from other forms of health care financing.)

Other courts, however, continue to refer to Brown Shoe.

See, e.g., Moore Corp. Ltd. v. Wallace Computer Services,

Inc., 1995 WL 727806, 70 Antitrust & Trade Reg. Rep.

(BNA) 55 (D. Del. 1995) (no separate market for sale of

business forms to large users).

2. Geographic Market.

The relevant geographic market is the "area of effective competition ... in which the seller operates and to which the purchaser can practically turn for supplies." U.S. v.

Philadelphia National Bank, 374 U.S. 321, 359 (1963). The

market must be defined so as to correspond to the

commercial realities of the industry and must be economically significant. Brown Shoe, 370 U.S. at 336-37. A restaurant in

Boston does not compete with a restaurant in San Francisco.

Thus they do not belong in the same geographic market. A brewery in Boston may or may not compete against a brewery in San Francisco, depending on what customers like and how well the beer travels. Thus they may or may not belong in the

same geographic market.

B. The Principal Ways In Which A Merger May Lessen Competition.

If there were only two producers of beer in the world and one proposed to merge with the other, that merger would obviously lessen competition. If, in fact, there are many producers of beer, and two of the smaller producers propose to merge so as not to be dwarfed by the market leaders, it is not obvious whether that merger would lessen competition, would strengthen competition, or would have no effect on competition. Two principal concerns have been articulated. They are customarily assessed by measuring the level of concentration of the relevant market, and then considering whether the market has any distinctive features such as barriers to entry.

1. Accumulation of Market Power.

A firm which accounts for a large percentage of the sales in the relevant market may have the power to raise price above the competitive level. This is termed market power.

See United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377, 391 (1956). A merger may make such a large firm larger, and thus may enhance its market power. For example, the Court barred a merger for this reason in United States v. Aluminum Co. of America, 377 U.S. 271 (1964).³

2. Ease of Collusion.

When there are relatively few firms in the market it is easier (all other things being equal) for them to conspire to fix prices and otherwise to interfere with the process of competition. For example, the court barred a merger in part for this reason in Hospital Corp. of America v. FTC, 807 F.2d 1381, 1386 (7th Cir. 1986), cert. denied, 481 U.S. 1038 (1987).

³ The courts formerly expressed a general distaste for mergers, finding unlawful even mergers involving businesses that had small shares of the relevant market. See, e.g., United States v. Von's Grocery Co., 384 U.S. 270, 277-78 (1966). Those cases are now largely outmoded.

3. Increase in Concentration.

These two dangers -- (1) accumulation of market power and (2) ease of collusion -- are customarily assessed indirectly by measuring the level of concentration in a market.

A market that has few producers (each having a large share of the market) is highly concentrated; and a merger that makes such a market more concentrated is generally thought likely to lessen competition. See United States v. Philadelphia National Bank, 374 U.S. 321 (1963). A market having a large number of producers (each with a small share of the market) is not concentrated; and a merger in such a market is generally thought not likely to lessen competition.

The federal enforcement agencies have stated an arithmetical test to measure the degree of concentration of a relevant market. See section III(B) below. This test is not binding on any court, but it has been noted with approval in a number of cases. See, e.g., FTC v. University Health, Inc., 938 F.2d 1206, 1991-2 Trade Cases ¶ 69,508 (11th Cir. 1991); Pearl Brewing Co. v. Miller Brewing Co., 1993-2 Trade Cases

(CCH) ¶ 70,370 (W.D. Tex. 1993), aff'd 52 F.3d 1066 (5th Cir. 1995).

4. Barriers to Entry.

In addition to measuring the level of concentration of the market, the enforcement agency or the court should take account of any distinctive features of the market that make it less likely (or more likely) that a merger will enhance market power or ease collusion. In particular, the barriers to entry are low in some markets. In these markets, if the post-merger firm attempted to raise prices above the competitive level, this would merely encourage new firms to enter the market and to bid the price back down. As a result, a merger in such a market is relatively less likely to harm competition. In other markets, the barriers to entry are high. In these markets, if the post-merger firm raised price above the competitive level, new firms could not enter the market fast enough to bid the price down. As a result, a merger in such a market is relatively more likely to harm competition. For example, in a recent case involving the merger of two collagen sausage

casing producers, the FTC believed it would take seven years before another company could enter the market. 69 Antitrust & Trade Reg. Rep. (BNA) 656 (Dec. 7, 1995). As a result, the FTC forced the two to sell off one set of assets. In re Devro, Int'l, PLC, 60 F.R. 65328 (Dec. 19, 1995)(proposed consent agreement).

The courts have recognized that the analysis of a merger should consider whether there are significant barriers to entry. See United States v. Baker Hughes, Inc., 908 F.2d 981 (D.C. Cir. 1990); Fruehauf Corp. v. FTC, 603 F.2d 345, 357 (2d Cir. 1979) ("high entry barriers may be a signal that a particular merger carries a potential for impairing competition").

In addition, a merger may itself increase barriers to entry, for example by limiting access to distribution sites, or by requiring a competitor to reach a large scale of operation in order to be successful. Mergers have been opposed as a result of such factors in Monfort of Colo., Inc. v. Cargill, Inc., 761 F.2d 570, 579 (10th Cir. 1985), rev'd on other grounds,

Cargill, Inc. v. Monfort of Colo., Inc., 479 U.S. 104 (1986)(merger of meat packing companies would raise barriers to entry, due to new plant costs, time to complete facilities, and low profit margins); and Consolidated Gold Fields, PLC v. Anglo Am. Corp., 698 F. Supp. 487, 501 (S.D.N.Y. 1988), aff'd in part and rev'd in part sub nom., Consolidated Gold Fields, PLC v. Minorco, SA, 871 F.2d 252 (2d Cir. 1989), cert. dismissed, Minorco, SA v. Consolidated Gold Fields, PLC, 492 U.S. 939 (1989)(merger would raise even higher the entry barriers in gold mining, which were already high due to capital costs, regulation of the industry, and limited supply).

5. Potential Competition..

Ordinarily, if two firms do not compete with one another, their merger does not lessen competition. The courts have noted, however, that in some rare cases a firm which has not yet entered the relevant market nonetheless threatens to enter, and thereby exerts pressure to keep prices at a competitive level. Such a firm is known as a potential

entrant. If an existing firm merges with a potential entrant, such a merger may lessen competition in two ways (at least in theory). First, perhaps the potential entrant would enter the market on its own absent the merger. In that case, there would be less competition with the merger than without it. See e.g., BOC International, Ltd. v. FTC, 557 F.2d 24, 28-29 (2d Cir. 1977) (party challenging the merger must show "reasonable probability" that potential entrant would have entered the market absent the merger). Second, perhaps the existing competitors merely believe that the potential entrant is likely to enter the market, and so they keep their prices competitive. In that case the merger may remove a factor which imposes competitive discipline. See United States v. Marine Bancorporation, 418 U.S. 602, 639-40 (1974). These theories are valid only as to a market which is already concentrated, and they are rarely applied.

C. Defenses.

More often than not, of course, there are pro-competitive reasons for a merger.

1. Efficiencies.

Firms often want to merge in order to consolidate costs or otherwise to make operations more efficient. Some courts have been willing to consider such efficiencies as a defense. See, e.g., United States v. Country Lake Foods, Inc., 754 F. Supp. 669, 680 (D. Minn. 1990). The Eleventh Circuit has stated that the proponent of such a defense should demonstrate that "the intended acquisition would result in significant economies and that these economies ultimately would benefit competition and, hence, consumers." FTC v. University Health, Inc., 938 F.2d 1206, 1223 (11th Cir. 1991). In addition, the proponent should demonstrate that the efficiencies could not be as well achieved by an alternative means. Id. at 1222 n.30.

To my knowledge, no court yet has permitted for efficiency reasons a merger that the court stated would lessen competition otherwise. The Supreme Court expressed hostility to efficiency arguments in older cases, reasoning that Congress intended to preserve competition whether that

would be efficient or not. See Brown Shoe Co. v. United States, 370 U.S. 294, 344 (1962); United States v. Philadelphia National Bank, 374 U.S. 321, 370-71 (1963).

2. Failing Firm.

Where one party to the merger would fail absent the merger, the merger will not lessen competition. A failing firm's death throes are likely to be inefficient, and once it has failed it cannot pressure other firms to keep their prices low. If a competing firm in the same market can acquire the failing firm's assets in an orderly way and can use them to increase production, that behavior is pro-competitive. Accordingly, the courts have recognized a failing firm defense in merger cases. See, e.g., International Shoe Co. v. FTC, 280 U.S. 291, 302-303 (1930).

The failing firm defense is narrow, however. The firm to be acquired must face "the grave probability of a business failure." Citizen Publishing Co. v. United States, 394 U.S. 131, 137 (1969). In addition, the merger must be the best of the alternative ways to save the failing firm. Thus, the

courts have sometimes required the failing firm to search diligently for other possible merger partners. In a brewery case, for example, the court rejected a failing firm defense where there was no proof that the failing firm "undertook a well-conceived and thorough canvas of the industry such as to ferret out viable alternative partners for merger." United States v. Pabst Brewing Co., 296 F. Supp. 994, 1002 (E.D.Wis. 1969).

D. Vertical Mergers.

Thus far, this outline has discussed mergers which are horizontal in nature, i.e., mergers which involve two firms that compete at the same level of distribution. Some mergers are "vertical" in nature, i.e. they involve firms at different levels of distribution. In Brown Shoe Co. v. United States, 370 U.S. 294 (1962), for example, Brown Shoe Co., a large shoe manufacturer, sought to merge with G.R. Kinney Co., another shoe manufacturer which also owned and operated a large chain of shoe stores. The Supreme Court feared that Brown would force its shoes into the Kinney retail outlets, thereby foreclosing other manufacturers from

important sales opportunities. Brown Shoe, 370 U.S. at 330-332. By tying a customer to a supplier, the Supreme Court said, a vertical merger may act as a "clog on competition." The federal Agencies have focused increasing attention on vertical mergers in the last two years, but litigated cases involving vertical mergers are still very rare.

III. ENFORCEMENT

The U.S. Department of Justice ("DOJ") and the Federal Trade Commission ("FTC") (jointly, the "federal Agencies") dominate merger enforcement more than they dominate enforcement of the other antitrust laws. Accordingly, merger analysis focuses largely on the enforcement policy of the federal Agencies.

A. The Federal Agencies.

1. The Federal Trade Commission.

The FTC is an administrative/judicial agency based in Washington with ten regional offices. It is divided into the Bureau of Competition (which enforces the antitrust laws), the Bureau of Consumer Protection, and the Bureau of Economics. The FTC has litigation capability as well as economic analysis capability. It is headed by five

Commissioners, who serve staggered terms lasting seven years. No more than three of the five may belong to the same political party. The five Commissioners make the ultimate decision whether to initiate litigation or to enter a consent decree. In addition, they rule on matters adjudicated within the FTC.

If the FTC chooses to litigate to block a merger, it most often seeks a preliminary injunction in a U.S. District Court. Whether or not it wins at this stage, the FTC may move on to litigate the merits before an administrative law judge ("ALJ") within the FTC. In August 1995 the FTC issued a Statement titled "Administrative Merger Litigation Following the Denial of a Preliminary Injunction."

According to that Statement, the agency will decide on a case-by-case basis whether to pursue administrative litigation where a district court denies temporary relief. In some such cases, the FTC may want to explore the implications of the merger in a full evidentiary record. See Final Rule at 60 F.R. 39640 (Aug. 3, 1995); 60 F.R. 39741 (Aug. 3, 1995)(agency

policy statement).

In FTC administrative litigation, the staff act as complaint counsel (the plaintiff) and the proponents of the merger act as defendants. This process can take just as much time and expense as an antitrust trial in the District Court. Once the ALJ reaches a decision, either party may appeal to the Commissioners, who sit as an appellate body. The Commissioners sometimes do oppose the position of staff counsel. Once the Commissioners issues a final decision, the private party may appeal to a Circuit Court of Appeal.

2. The Department of Justice.

The Antitrust Division is a branch of the DOJ, headquartered in Washington and with 10 regional offices. The Assistant Attorney General for the Antitrust Division is ultimately responsible for its decision whether to challenge a merger or to enter a consent decree or other settlement. If it does decide to challenge a merger, the DOJ must bring suit in U.S. District Court.

B. The Federal Merger Guidelines.

The DOJ and the FTC have issued joint Horizontal Merger Guidelines, most recently in 1992 (the "Federal Guidelines"). They are reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,104, as well as in ABA, Antitrust Law Developments (3rd), Appendix F (1992).

Copies are available from the federal Agencies.

The courts, of course, are not bound by the Guidelines of the federal Agencies. See Olin Corporation v. FTC, 986 F.2d 1295 (9th Cir. 1993), cert. denied, 114 S.Ct. 1051 (1994). Nonetheless, several courts have pointed to the Federal Guidelines in the course of exposition or by way of illustration. These cases include: U.S. v. Eastman Kodak Co., 63 F.2d 95 (2nd Cir. 1995); FTC v. University Health, Inc., 938 F.2d 1206, 1991-2 Trade Cases ¶ 69,508 (11th Cir. 1991); State of N.Y. v. Kraft General Foods, Inc., 1995-1 Trade Cases ¶ 70,911 (S.D.N.Y., Feb. 23, 1995); Wallace Oil Co., Inc. v. Michaels, 839 F.Supp. 1041 (S.D.N.Y., Dec. 14, 1993); Pearl Brewing Co. v. Miller Brewing Co., 1993-2 Trade Cases (CCH) ¶ 70,370 (W.D. Tex. 1993), aff'd 52 F.3d 1066 (5th Cir. 1995) (DOJ's and FTC's expertise in these matters is entitled to some consideration by

the court); SCFC ILC, Inc. v. Visa U.S.A. Inc., 819 F. Supp. 956, 1993-1 Trade Cases ¶ 70,217 (D. Utah 1993), aff'd in part and rev'd in part, SCFC ILC, Inc. v. Visa U.S.A. Inc., 36 F.3d 958 (10th Cir. 1994), cert. denied MountainWest Financial Corp. v. Visa U.S.A. Inc., 155 S.Ct. 2600 (1995); Com. of Pa. v. Russell Stover Candies, Inc., 1993-1 Trade Cases ¶ 70,224 (E.D. Pa. 1993); United States v. Archer-Daniels-Midland Co., 781 F. Supp. 1400, 1991-2 Trade Cases ¶ 69,647 (S.D. Iowa 1991); and United States v. United Tote, Inc., 768 F. Supp. 1064, 1991-1 Trade Cases ¶ 69,434 (D. Del. 1991).

C. The Federal Merger Guidelines - Market Definition.

1. Product Market.

The federal Agencies define the relevant product market by asking an economic question. Focusing initially on the merging firms and their closest competitors, what would happen if these firms were to raise price by a small but significant amount for a nontransitory period? (As a rule of thumb, the Guidelines start out by positing an increase of 5% sustained for the foreseeable future.) On the one hand, if such a price increase would be profitable, then the Agencies

presume that those firms define the relevant market. On the other hand, if such a price increase would drive consumers to buy other products (perhaps those offered by new entrants), then the Agencies presume that the substitute products also should be included in the relevant market. For example, if all producers of cellophane together could not profitably sustain a price increase of 5% for the foreseeable future, then producers of aluminum foil should also be included in the relevant market. In practice, generally there is no direct evidence of what would happen in the event of such a price increase, and thus the DOJ/FTC test may be characterized as a thought experiment.

2. Geographic Market.

The Federal Guidelines employ the same test to define the relevant geographic market. Federal Guidelines at § 1.2. The Agencies begin with the primary service areas of the merging firms. If the firms serving this area could profitably sustain a price increase, then they are deemed to define the geographic scope of the market. If a price increase

would drive consumers to switch to firms located elsewhere, then those other firms also should be included in the relevant geographic market. Several recent cases involving hospital mergers have focused attention on difficulties in defining the relevant geographic market. See Part IV(B) below.

D. The Federal Guidelines -- Ways In Which A Merger May Lessen Competition.

1. Increase in Concentration.

Once the relevant market has been defined, the Federal Guidelines employ an arithmetical index to calculate the degree of concentration in that market. This index is known as the Herfindahl-Hirschman Index ("HHI"). The HHI measures to what extent sales are concentrated in a few large firms. In order to calculate the HHI, one must:

- * list each of the significant firms in the market;
- * determine each firm's percentage of the market;
- * square the percentages; and
- * add the resulting squares.

For example, in a market with two equal firms, each having 50% of the market, the HHI is 5,000 (2,500 + 2,500).

In a market with ten equal producers, each having 10%, the HHI is 1,000 ($100 + 100 + 100 + 100 + 100 + 100 + 100 + 100 + 100 + 100$).

The Federal Guidelines state thresholds at which the DOJ/FTC presumptively will or will not challenge a merger. The federal Agencies, of course, reserve the right to depart from their presumptions in practice. Nonetheless, the stated thresholds provide a useful rule of thumb:

- * A market with an HHI below 1,000 is deemed to be not concentrated. If the HHI would remain below 1000 after the proposed merger, no further analysis is required.

Federal Guidelines at § 1.51(a).

- * A market with a post-merger HHI between 1,000 and 1,800 is deemed to be moderately concentrated. If a merger would increase the HHI of such a market by 100 points or more, the federal Agencies presumptively will consider this to be of significant concern, and will go on to look at other factors such as barriers to entry and likely efficiencies. Federal Guidelines at § 1.51(b).

- * A market with an HHI over 1,800 is deemed to be highly concentrated. If a merger would increase the HHI of such a market by 50 or more, the federal Agencies presumptively will challenge the merger. Federal Guidelines at § 1.51(c).

These thresholds indicate the zones in which the proponents of a merger will need to work hard to convince the federal Agencies that the merger is not likely to lessen competition.

2. Barriers to Entry.

The federal Agencies recognize the importance of analyzing barriers to entry. "A merger is not likely to create or enhance market power or to facilitate its exercise, if entry into the market is so easy that market participants, after the merger, either collectively or unilaterally could not profitably maintain a price increase above premerger levels." Federal Guidelines at § 3.0. The Federal Guidelines state a three-part test to determine whether entry would be so easy. First, can entry "achieve significant market impact within a timely period," i.e. within two years? *Id.* at §§ 3.0, 3.2. Second, is entry likely, i.e., would entry be profitable at premerger prices and

can the entrant make sales of those prices? Id. at § 3.3. Third, will entry be sufficient in magnitude, character and scope to constrain the anti-competitive effects of the merger? Id. at §§ 3.0, 3.3.

E. The Federal Merger Guidelines -- Defenses.

1. Efficiencies.

The federal Agencies recognize that mergers may strengthen competition by improving efficiency. "The primary benefit of mergers to the economy is their efficiency-enhancing potential, which can increase the competitiveness of firms and result in lower prices to consumers." Federal Guidelines at § 4.0. The parties must make a strong case in order to persuade the Agencies that efficiencies predominate, however. The parties must demonstrate specific savings which arise from economies of scale, better transportation costs, or other identifiable factors. Id. The parties must demonstrate that these savings cannot reasonably be achieved by other means. Id. And the parties must demonstrate that these savings outweigh the otherwise anti-competitive effect of the merger in its particular market. Id. Where the parties

can demonstrate such savings, the federal Agencies are willing to take them into account, acknowledging that "[s]ome mergers that the agency otherwise might challenge may be reasonably necessary to achieve significant net efficiencies."

Id.

The hearings conducted by the FTC at the end of 1995 included extensive discussion of the role to be played by analysis of efficiencies. See 69 Antitrust & Trade Regulation (BNA) 719.

2. Failing Firm.

The federal Agencies recognize that a merger will not lessen competition if one of the merging firms would otherwise fail and exit the market. The federal Agencies set a strict test for the failing firm defense, however. First, the firm must be "unable to meet its financial obligations in the near future." Federal Guidelines at § 5.1. Second, the firm must not be able "to reorganize successfully under Chapter 11." Id. Third, the firm must have "made unsuccessful good-faith efforts to elicit reasonable alternative offers." Id.

Fourth, the firm must show that "absent the acquisition, the assets of the failing firm would exit the relevant market." Id.

These conditions describe an extreme case. They require the firm to wait until the last minute and to have exhausted other options. Under the standards of the federal Agencies, it is not enough that one of the merging firms is weak compared to its competitors.

3. Strengthening A Smaller Competitor.

The Federal Guidelines do not recognize that strengthening a smaller competitor may enhance competition. However, the federal Agencies will not likely challenge a merger that involves firms having a small share of the market. Such a merger will not be deemed to have anti-competitive effects. "Mergers that either do not significantly increase concentration or do not result in a concentrated market ordinarily require no further analysis." Federal Guidelines at § 1.0.

F. Federal Enforcement -- Vertical Mergers.

The federal Agencies during the Clinton Administration have

challenged several vertical mergers which they believed could foreclose rivals from competitive opportunities. For example, the Agencies recently settled vertical merger cases involving (1) Silicon Graphics, 60 F.R. 35,032 (work station manufacturer, which acquired two software firms, must continue to assist independent software producers); and (2) Eli Lilly and Co., 5 Trade Reg. Rep. (CCH) ¶ 23,873 (pharmaceutical benefit management firm, acquired by a pharmaceutical manufacturer, must not unduly favor the drugs manufactured by its new parent).

There are no current enforcement guidelines specific to vertical mergers. In part the Agencies may look to the previous (1984) Merger Guidelines, reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,103. The 1984 Guidelines noted that vertical mergers could facilitate collusion and could raise barriers to entry, but stated that a vertical merger would not likely be challenged unless the upstream market was highly concentrated. In addition, the agencies are likely to ask whether the merger will raise the cost of entry, by making it necessary for potential rivals to enter at two levels.

G. Premerger Notification.

The parties to most large mergers must notify the DOJ and FTC in advance under the Hart-Scott-Rodino Act, 15 U.S.C. § 18a. This section sketches the premerger notification process in broad outline. It is important to consider for every merger or acquisition whether a Hart-Scott-Rodino filing may be required.

1. Purpose.

The Hart-Scott-Rodino Act establishes a 30-day waiting period. During this period the parties may not consummate their merger, and the federal Agencies have an opportunity to analyze the transaction before it closes.

2. Application.

The statute sets forth monetary thresholds above which the premerger filing is required. Generally speaking, a Hart-Scott-Rodino filing is required if: (a) the size of the parties exceeds a stated threshold; and (b) the size of the transaction exceeds a stated threshold.

a. The size of the parties threshold is met where:

* one party has annual net sales or total assets of \$100

million or more; and

- * the other party has annual net sales or total assets of \$10 million or more.
- b. The size of the transaction threshold is met where the transaction involves either:
 - * 15% of the voting securities or assets of the acquired party; or
 - * voting securities and assets with a total value of \$15 million or more.

15 U.S.C. § 18a(a). These filing rules are further developed in regulations at 16 C.F.R. § 800 et seq. Counsel should review the statute and the governing regulations in connection with any large merger or acquisition.

3. Exemptions.

The Hart-Scott-Rodino Act and accompanying regulations provide exemptions to the reporting requirements. Among the notable exemptions are the following: "(1) acquisitions of goods or realty transferred in the ordinary course of business"; "(4) transfers to or from a

Federal agency or a State or political subdivision thereof"; and "(9) acquisitions, solely for the purpose of investment, of voting securities, if, as a result of such acquisition, the securities acquired or held do not exceed 10 per centum of the outstanding voting securities of the issuer." See 18 U.S.C. § 18a(c); 16 C.F.R., § 802.

4. Nature of Filing.

The Hart-Scott-Rodino filing requires a detailed form, an accompanying submission of documents, and a filing fee of \$45,000. The fee was increased from \$25,000, effective August 29, 1994.

Item 4(c) of the form calls for "all studies, surveys, analyses and reports, which were prepared by or for any officer(s) or director(s) ... evaluating or analyzing the acquisition with respect to market shares, competition, competitors, markets, potential for sales growth or expansion into product or geographic markets." The 4(c) documents can give the federal Agencies a feeling for the intent of the parties--sometimes in ways that are not to the parties' benefit.

For example, when the DOJ sued to block the merger of Microsoft and Intuit, the DOJ's Complaint quoted directly from internal documents of the two parties. Firms and their advisers should avoid loose talk in their documents.

5. Waiting Period and Second Request.

The parties may not consummate the merger until 30 days have passed after they make a complete Hart-Scott-Rodino filing. If the DOJ/FTC staff find an error in the filing, the parties may be required to make a new filing, which starts a new 30-day waiting period. If the FTC/DOJ take no action before the 30 days have passed, then the parties may proceed to consummate the acquisition.

Where a transaction raises significant antitrust issues in the view of the FTC/DOJ, the Agency will make a "second request" for further documents or information before the 30 days have passed. A model form of second request is contained in Guide 5 of the FTC's Introductory Guides to the Premerger Notification Program, reprinted in 4 Trade Reg. Rep. (CCH) ¶ 42,505. When the DOJ/FTC

makes a second request, this shifts the time pressure to the merging parties to comply. Once the parties achieve compliance with the second request, that shifts the time pressure back to the DOJ/FTC, which then has another 20 days (unless an extension is sought) to decide whether to challenge the merger. 15 U.S.C. § 18a(e)(2).

6. Penalties.

A party which fails to make a complete and accurate Hart-Scott-Rodino filing when required may be liable for fines of up to \$10,000 per day, and its directors and officers also may be liable. 15 U.S.C. § 18a(g)(1). For example, Sara Lee Corp. recently agreed to pay \$3.1 million to settle charges that it deliberately avoided filing when it acquired a British shoe polish company. *New York Times* (February 7, 1996), p. D4.

7. Questions?

Counsel may call the Premerger Notification Office of the FTC Bureau of Competition at (202) 326-3100 to ask questions about the Hart-Scott-Rodino process. The

Premerger Notification Office has issued a series of Introductory Guides. They are reprinted in 4 Trade Reg. Rep. (CCH) ¶¶ 42,501-05. They include: "Guide I: What Is The Premerger Notification Program? An Overview;" "Guide II: To File Or Not To File;" and Guide V: a model form of a second request. (Guides III and IV have not yet been published.) A few formal interpretations of the Office are compiled in 6 Trade Reg. Rep. (CCH) at ¶ 42,415.

In addition, the ABA has published a useful manual titled ABA Antitrust Section, Premerger Notification Practice Manual (2d ed. 1991), which digests many interpretations by the Office.

H. The State Attorneys General.

The states began to assert a significant role in merger enforcement during the Reagan Administration. For example, in 1988 the states of Massachusetts, Maine, and New Hampshire challenged the acquisition of Filene's Department Stores by a competitor, obtaining a series of divestitures as a condition of permitting the acquisition to proceed. See Massachusetts v. Campeau

Corp., 1988-1 Trade Cases (CCH) ¶ 68,093 (D. Mass. 1988). The Supreme Court held in California v. American Stores Co., 495 U.S. 271 (1990), on remand, 930 F.2d 776 (1991), that a state may seek the remedy of divestiture even after a merger has been consummated.

The National Association of Attorneys General ("NAAG") has issued its own Horizontal Merger Guidelines ("NAAG Guidelines"). They are reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,406 (April 1, 1993).

1. Product Market

Drawing a contrast to the abstract approach of the Federal Guidelines, the NAAG Guidelines state a desire to "utilize historical data" -- and they express a preference for narrow market definitions. NAAG Guidelines at § 3. "Each product produced in common by the merging parties will constitute a provisional product market," they state. Id. at § 3.1. The provisional definition of the market will be expanded to include substitutes only if they are "considered suitable by customers accounting for seventy-five percent of the purchases." Id.

The NAAG Guidelines state that a party may present a position using the methodology of the Federal Guidelines, but only where "sufficient evidence is available to implement the methodology workably and without speculation." NAAG Guidelines at § 3A. The NAAG acknowledge, however, that "[i]n most situations, both the NAAG and DOJ/FTC market definition methodologies will produce the same result." *Id.*

2. Geographic Market.

The NAAG Guidelines define the relevant geographic suppliers as "the sources and locations where the customers of the merging parties readily turn for their supply of the relevant product." NAAG Guidelines at § 3.2. This includes "all sources of supply within the past two years still present in the market." *Id.*

3. Increase In Concentration.

Like their federal counterpart, the NAAG Guidelines employ the HHI to measure the concentration of the relevant market. NAAG Guidelines at § 4. They "divide the spectrum of market concentration into the same three

numerical regions utilized by" the Federal Guidelines. Id.

4. Barriers To Entry.

The NAAG Guidelines recognize that a merger is not likely to have anti-competitive effects if entry is easy. NAAG Guidelines at § 5.11. They state a three-part analysis which is quite similar to the analysis of the federal Agencies. First, can entry "achieve significant market impact within a timely period," i.e. within two years? Id. at §§ 5.11, 5.12. Second, would entry "be profitable at premerger prices without exceeding the likely sales opportunities?" Id. at §§ 5.11, 5.13. Third, would timely and likely entry "be sufficient to return market prices to their premerger levels?" Id. at §§ 5.11, 5.14.

5. Efficiencies.

The NAAG Guidelines express hostility to efficiencies defenses. "Even in those rare situations where significant efficiencies can be demonstrated, rather than merely predicted, this showing cannot constitute a defense to an otherwise unlawful merger." NAAG Guidelines at § 5.3. One may argue that this formulation begs the question, since

a merger that has pro-competitive effects -- due to efficiencies -- need not be considered unlawful in the first place.

6. Failing Firm.

The NAAG Guidelines recognize that "[t]he failing firm doctrine ... may be a defense to an otherwise unlawful merger." NAAG Guidelines at § 6. However, the defense "will be strictly construed." Id. First, the parties must show that "the resources of the allegedly failing firm are so depleted and the prospect of rehabilitation is so remote that the firm faces a high probability of a business failure." Id. Second, the parties must show that the firm "had made reasonable good faith efforts and had failed to find another reasonable prospective purchaser." Id. Third, the parties must show that "there is no less anti-competitive alternative available." Id. This combination of factors is likely to arise very rarely. Like the Federal Guidelines, the NAAG Guidelines do not recognize a defense for a firm which is merely weak.

7. Multi-State Investigation.

Nearly all of the NAAG members have entered a compact concerning multi-state investigation. It is reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,410. The compact applies to mergers that may be investigated by several states. It is intended to coordinate such investigations so that the merging parties may make production of documents to a single lead state only.

I. Private Enforcement.

An appropriate private party may bring suit to challenge a merger either before or after it is consummated. Recent decisions have made it increasingly difficult, however, for a private party to demonstrate the requisite antitrust standing.

The Supreme Court established in Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477 (1977), that a private party must show injury "of the type the antitrust laws were designed to prevent and that flows from that which makes defendant's acts unlawful." The plaintiffs in Brunswick were three bowling centers, one in Pueblo, Colorado, one in Poughkeepsie, New York, and one in

Paramus, New Jersey. The defendant, Brunswick Corp., was a large manufacturer of bowling equipment, and also owned bowling centers across the country. The plaintiffs sued to challenge Brunswick's acquisition of bowling centers in their cities. These bowling centers were likely to fail if they were not acquired. The plaintiffs stood to benefit if the rival bowling centers failed, because there would be less competition, and the plaintiffs stood to be harmed if Brunswick could maintain these centers as viable competitors. The Court held that the plaintiffs' threatened injury was not "of the type the antitrust laws were designed to prevent." 429 U.S. at 477. It therefore held that the plaintiffs could not recover damages, and threw out a jury verdict in the plaintiffs' favor.

Cargill, Inc. v. Monfort of Colorado, Inc., 479 U.S. 104 (1986) reached a similar result. When two meat packing companies sought to merge, another large integrated beef packer brought suit claiming that the increased competition would cause a "price-cost squeeze." The Court held that the plaintiff had not demonstrated antitrust injury. The Court declined, however, to adopt a universal rule which would prohibit competitors from challenging acquisitions

that might further predatory pricing. 479 U.S. at 120-21.

As a result of these and other decisions, a competitor may demonstrate standing to challenge a merger only if it can show that the merger will result in particular anti-competitive practices. For example, the plaintiff competitor may attempt to show that the post-merger firm will engage in predatory pricing. See R.C. Bigelow, Inc. v. Unilever N.V., 867 F.2d 102 (2nd Cir. 1989), cert. denied, Thomas J. Lipton, Inc. v. R.C. Bigelow, 493 U.S. 815 (1989); Cia. Petrolera Caribe, Inc. v. Arco Caribbean, Inc., 754 F.2d 404 (1st Cir. 1985); Tasty Baking Co. v. Ralston Purina, Inc., 653 F. Supp. 1250, 1272 (E.D. Pa. 1987); Christian Schmidt Brewing Co. v. G. Heileman Brewing Co., 600 F. Supp. 1326 (E.D. Mich. 1985), order aff'd, 753 F.2d 1354 (1985), cert. dismissed, G. Heileman Brewing Co. v. Christian Schmidt Brewing Co., 469 U.S. 1200 (1985). See ABA, Antitrust Law Developments (3d) (1992) at 362, n. 539 (collecting cases).

A distributor of products usually will not have standing to challenge a merger at the manufacturing level. See, e.g., Florida Seed Co., Inc. v. Monsanto Co., 7 Trade Reg. Rep. (CCH) ¶ 71,240 (M.D.

Ala. 1995) (terminated distributor did not have standing); G.K.A. Beverage Corp. v. Honickman, 55 F.3d 762 (2nd Cir. 1995), cert. denied 116 S.Ct. 381 (1995)(distributors lacked standing to allege that a conspiracy sought to drive their supplier out of business).

A customer may have standing to challenge a merger if it believes the merger will lessen competition. Reiter v. Sonotone, 442 U.S. 330 (1979). A customer does not usually have a sufficient financial incentive to undertake expensive antitrust litigation, however. Instead of bringing suit, a customer is more likely to complain to the federal or state enforcement agencies.

J. Remedies.

1. Injunctions.

The party challenging a merger may seek a preliminary injunction to block the merger under 15 U.S.C. § 26, and may also seek a permanent injunction.

2. Divestiture.

A plaintiff may seek divestiture even after a merger has been consummated. California v. American Stores Co., 495 U.S. 271 (1990), on remand, 930 F.2d 776 (1991).

3. Limitations.

Equitable actions by the government are not subject to a statute of limitation, and it is often thought that laches cannot ordinarily be asserted against the government. See P. Areeda & L. Kaplow, Antitrust Analysis: Problems, Text, Cases (4th ed. 1988) at ¶ 160. However, one Supreme Court Justice has suggested that the doctrine of laches may bar a state from suing later, if the state elected not to challenge a merger when it received a copy of the Hart-Scott-Rodino filing. See California v. American Stores, 495 U.S. 271, 297-98 (1990) (concurring opinion of Justice Kennedy).

Similarly, there is no express statute of limitation for a private suit seeking injunctive or other equitable relief. However, IT&T Corp. v. General Telephone & Electric Corp., 518 F.2d 913, 928 (9th Cir. 1975) suggests that four years is the appropriate period for applying the doctrine of laches.

4. Damages.

Where a merger is found to be anti-competitive,

damages are available in theory, but are rarely awarded in practice. The statute of limitations for a private suit for damages is four years. See 15 U.S.C. § 15b. A damages suit brought by the U.S. government under § 4A of the Clayton Act -- for injury to its own business or property -- is subject to the same time limitation. The U.S. government may also sue for damages on behalf of an aggrieved party. State Attorneys General may sue for treble damages and the costs of suit while acting in the role of parens patriae. See 15 U.S.C. § 15 (1990).

K. Fixes.

Because merger litigation is so expensive (and because the outcome is often uncertain) in many cases it is prudent to fix the problem rather than to litigate. For example, when Kimberly-Clark Corp. merged with Scott Paper Co., they agreed to sell off Scott's facial tissue and baby wipes business, in order to resolve a challenge by the DOJ and the State of Texas. See 6 Trade Reg. Rep. (CCH) ¶ 45,095 (case no. 4183).

Of course, sometimes the proposed "fix" fails to satisfy the

Agencies, as when Microsoft sought to acquire Intuit. Intuit had the leading personal finance software program ("Quicken"), and Microsoft had the next most successful program ("Money"). Microsoft proposed to give away its brand, so that the merger would not combine the two. The DOJ rejected this "fix". 6 Trade Reg. Rep. (CCH) ¶ 45,095 (case no. 4131). The DOJ apparently believed that the status quo kept Microsoft as a strong number two competitor, whereas the merger would allow Microsoft to stifle competition once it became number one. Microsoft and Intuit abandoned the transaction after the DOJ filed suit.

IV. AN ILLUSTRATION: MERGERS AND AFFILIATIONS OF HOSPITALS

This section illustrates how fundamental antitrust principles are being applied to one particular phenomenon, mergers and affiliations of hospitals. Market pressures have caused an unprecedented wave of hospital mergers and affiliations in recent years. Many of these mergers and affiliations have gone unchallenged, but a significant number have been investigated -- and some have been challenged and blocked. For the most part, the enforcement agencies have applied traditional antitrust analysis, rejecting hospitals' contention that competition does not operate in the traditional fashion in

hospital markets.

In many transactions, hospital corporations join forces by forming a common super-parent, rather than by merging. Assuming that the common super-parent is to have control over each hospital, such an affiliation is subject to the same antitrust laws that govern mergers. (This includes the Hart-Scott-Rodino Act, where it is applicable.)

A. Product Market.

In analyzing a hospital merger, the federal Agencies begin with a presumption that the relevant product market involves the cluster of inpatient services which are offered only by hospitals. See, e.g., U.S. v. Mercy Health Services., 1995-2 Trade Cases (CCH) ¶ 71,162 (N.D. Iowa); 59 Antitrust & Trade Reg. Rep. (BNA) 296 (August 23, 1995)(reporting remarks of the Acting Assistant Director of the FTC's San Francisco Regional Office). Obviously, the cluster of services offered by a community hospital is different from the cluster of services offered by a tertiary care hospital, and the enforcement agencies may be willing to recognize this difference in an appropriate case. All hospitals face significant competition from out-patient clinics and from physicians' offices (both in ancillary

services, such as x-rays and laboratory tests, and in direct services, such as outpatient surgery). However, the enforcement agencies have been reluctant to include such clinics in the relevant product market. Id.

In the reported cases, the courts agreed with the Agency's definition of the relevant product market in Hospital Corp. Of America v. FTC, 807 F.2d 1381 (7th Cir. 1986), cert. denied, 481 U.S. 1038 (1987) and in U.S. v. Rockford Memorial Corp., 717 F. Supp. 1251 (W.D. Ill. 1989), aff'd, 898 F.2d 1278 (7th Cir. 1990), cert. denied, 498 U.S. 920 (1990). The court disagreed with the Agency's definition of the relevant product market in U.S. v. Carilion Health Systems, 707 F. Supp. 840 (W.D. Va. 1989), aff'd per curiam in unpublished opinion, 1989-2 Trade Cases (CCH) ¶ 68,859 (4th Cir. 1989), stating that outpatient clinics should also be included insofar as primary care is concerned. In the two most recent reported cases (involving mergers in Joplin, Missouri and Dubuque, Iowa), the parties did not dispute the scope of the product market, and instead fought over the scope of the geographic market. See FTC v. Freeman Hospital, 1995-2 Trade Cases (CCH) ¶ 71,167 (8th Cir.

1995); U.S. v. Mercy Health Services, 1995-2 Trade Cases (CCH) ¶ 71,162 (N.D. Iowa 1995).

B. Geographic Market.

The federal Agencies begin with a presumption that hospital markets have a small geographic scope. As Judge Posner said in U.S. v. Rockford Memorial Corp., 898 F.2d 1278, 1285 (7th Cir. 1990), "for the most part hospital services are local."

In order to define the relevant geographic market, the federal Agencies often employ the Elzinga-Hogarty test, which measures in-flow and out-flow to and from the proposed geographic area. For a brief introduction to the Elzinga-Hogarty test, see Vita, et al, "Economic Analysis and Health Care Antitrust," contained in ABA, Antitrust Health Care: Enforcement and Analysis (Gee, ed.) (1992) at 65.

The courts have criticized this method, however, because it relies on a frozen snapshot of the market, and does not consider a possible dynamic response to a price increase. The Eighth Circuit stated this criticism in FTC v. Freeman Hospital, 1995-2 Trade Cases (CCH) ¶ 71,167 (8th Cir. 1995)(rejecting FTC challenge to merger of

hospitals in Joplin, Missouri). The district court stated this criticism in U.S. v. Mercy Health Services, 1995-2 Trade Cases (CCH) ¶ 71,162 (N.D. Iowa 1995)(rejecting DOJ challenge to merger of hospitals in Dubuque, Iowa). Perhaps most notably, the FTC itself suggested this criticism in Adventist Health System/West, 5 Trade Reg. Rep. (CCH) ¶ 23,591 (1994)(rejecting staff challenge to merger of hospitals in Ukiah, California). Of course, there will almost never be direct evidence of how consumers react to a price increase or other dramatic change in market conditions. Thus once these cases reach litigation, the Agencies and the parties must attempt to convince the courts by drawing inferences from limited data.

The most dramatic ruling came in the Dubuque, Iowa case. There were only two hospitals in Dubuque. The nearest comparable hospital is 70-100 miles away. The Dubuque hospitals presented evidence, however, that they had to compete for patients who live in the direction of other cities with substantial hospitals, such as Madison, Wisconsin. Further, the Dubuque hospitals presented evidence that hospitals in Madison, Wisconsin could and did set up outreach clinics in intermediate towns. These outreach clinics

allowed the Madison hospitals to compete for admissions without building a large facility near Dubuque. The district court stated that the loss of a modest percentage of patients, such as those located in intermediate towns, would make a price increase unprofitable. The district court ruled that the relevant geographic market included a three county area, extending into Wisconsin and Illinois. As a result, the DOJ's challenge failed.

In the other reported cases, the court agreed with the Agency's definition of the geographic market in Hospital Corp. Of America v. FTC, 807 F.2d 1381 (7th Cir. 1986), cert. denied, 481 U.S. 1038 (1987). The court disagreed with the Agency's definition of the relevant geographic market in U.S. Carilion Health Systems, 707 F. Supp. 840 (W.D. Va. 1989), aff'd per curiam in unpublished opinion, 1989-2 Trade Cases (CCH) ¶ 68,859 (4th Cir. 1989), stating that two hospitals in Roanoke, Virginia competed with hospitals located in much of Virginia and part of North Carolina. The court also disagreed with the Agency's definition of the relevant market in U.S. v. Rockford Memorial Corp., 717 F. Supp. 1251 (N.D. Ill. 1989), aff'd, 898 F.2d 1278 (7th Cir. 1990), cert. denied, 498 U.S. 920 (1990),

stating that the relevant geographic area included six acute care hospitals, where the DOJ had said it included only three.

Even though they do not show how patients may travel in the future, recent patient origin data are still the best place to start in defining the relevant geographic market. The Massachusetts Attorney General's office has issued Guidelines for Mergers and Similar Transactions Involving Hospitals (Aug. 19, 1993), reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,450, which explain how one state's Attorney General's Office looks at these data. The Pennsylvania Attorney General's Office has also released a statement regarding Horizontal Mergers of Hospitals. 4 Health Law Reporter (BNA) 3 (Jan. 19, 1995).

C. Increase In Concentration Levels.

Once one has made a trial definition of the relevant geographic market, one may calculate the HHI for that trial market, and one may project the increase in the HHI as a result of the merger. Because there are only a handful of hospitals in most markets, this exercise will often show a degree of concentration that raises concern under the Federal or the NAAG Guidelines. This

does not necessarily mean that the agencies are likely to challenge the merger. It does mean, however, that the parties would be wise to invest in a thorough and imaginative antitrust analysis.

The federal Agencies recognize generally that a hospital merger is not likely to lessen competition -- despite an increased level of concentration -- where "the merger would not increase the likelihood of the exercise of market power either because of the existence post-merger of strong competitors or because the merging hospitals were sufficiently differentiated." Statements of Enforcement Policy and Analytical Principles Relating to Health Care and Antitrust, issued by the DOJ and the FTC on September 27, 1994, p. 14 (hereinafter, "Health Care Policy Statements"), reprinted in 4 Trade Reg. Rep. (CCH) at ¶ 13,152.

D. Defenses.

1. Efficiencies.

Hospitals frequently assert that it is inefficient for two hospitals in a small city to duplicate services, physical plant and administrative staff. Hospitals seeking to affiliate often believe they can achieve substantial cost-savings. The federal

and state agencies have shown a willingness to examine these claims. The federal Agencies have acknowledged that they may decide not to challenge a hospital merger where "the merger would allow the hospitals to realize significant cost savings that could not otherwise be realized." Health Care Policy Statements, p. 14. However, the agencies expect to see substantial evidence that such efficiencies will be achieved -- and sometimes demand that the resulting cost-savings should be passed on to consumers. In the 1994 merger of hospitals in Williamsport and Mercy, Pennsylvania, for example, the hospitals settled the state's challenge by promising to save at least \$40 million dollars -- and to pass on to consumers \$31.5 million of the savings. If the hospitals fail to achieve these cost-savings, they must pay a like sum directly to the Pennsylvania Attorney General's office. Pennsylvania v. Providence Health Systems, Inc., (M.D. Pa. 1994) 1994-1 Trade Cases (CCH) ¶ 70,603. The Pennsylvania Attorney General's Office entered a similar consent decree a year later in Pennsylvania v. Capital Health System Services, 1995-2

Trade Cases (CCH) ¶ 71,205 (M.D. Pa. 1995).

One court has stated that a strong demonstration of efficiencies can save a merger that would otherwise be deemed anti-competitive. FTC v. University Health Inc., 938 F.2d 1206, 1222-23 (11th Cir. 1991). That court ruled, however, that the hospitals had not presented sufficient evidence that efficiencies of the merger would benefit consumers, or that the expected benefits of efficiencies would exceed the expected harm to competition.

In any close case the hospitals should plan to develop a thorough efficiency study, and to start it early in the merger process. The agencies and the courts may be suspicious of a study that comes late in the day. As the court stated in U.S. v. Rockford Memorial Corp., 717 F. Supp 1251, 1289 (N.D. Ill. 1989), aff'd, 898 F.2d 1278 (7th Cir. 1990):

The court is initially suspicious of the defendants' savings schedule because of the relatively little attention placed on savings by the defendants in planning for and agreeing upon the merger. The formal study of efficiencies was hastily commenced well after the announcement of the

merger.

Finally, Commissioners of the FTC have recently indicated they are willing to listen to claims that hospitals must merge in order to operate efficiently. In May 1995 Commissioner Christine Varney stated that the FTC may begin placing greater emphasis on efficiencies in hospital mergers, backing away from the current standard of "clear and convincing" evidence. In light of excess capacity in hospitals, according to Commissioner Varney, efficiencies should be given significant weight as against unreliable or inconclusive geographic and product market definitions. 68 Antitrust & Trade Reg. Rep. (BNA) 579 (May 4, 1995). The ultimate question, she said, will be whether hospital mergers "provide better health care services to more at a lower cost."

Id.

2. Failing Firm.

The "failing firm" defense may be available for a merger where a hospital is about to close its doors. The federal Agencies have acknowledged that they may decide not

